The Foreign Corrupt Practices Act: Compliance Issues in the Tax and Customs Arena

By Kathryn Cameron Atkinson and James G. Tillen

Among the many changes in the legal and business landscape following the Enron scandal and the Sarbanes-Oxley Act of 2002 has been a dramatic increase in the pace and ferocity of enforcement of the Foreign Corrupt Practices Act (FCPA), which prohibits improper payments to influence foreign officials who have the power to affect a company's business.[1] Enforcement officials at the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) are pursuing more and more cases and securing settlements that include criminal fines and penalties, disgorgement of ill-gotten gains, prison terms for individual wrongdoers, and ongoing compliance monitoring obligations. Recent FCPA cases have been closely followed in the press, in boardrooms, and in sales meetings, and have prompted many companies to redouble their anti-corruption compliance efforts. One lower-profile aspect of these cases is that they arise not only in the traditional area of government procurement, but also in the arenas of customs duties, tax assessments, and tax controversies.

KATHRYN CAMERON ATKINSON is a Member of Miller & Chevalier Chartered in Washington, D.C., where she coordinates the firm's International Regulatory Compliance practice group. Ms. Atkinson's practice includes advising clients on the U.S. Foreign Corrupt Practices Act and other regulatory compliance issues in business transactions, developing and auditing company compliance programs, conducting internal investigations, conducting compliance due diligence, and representing clients in enforcement actions and litigation involving international regulatory issues. She is a graduate of The Johns Hopkins University and Cornell Law School, where she was Executive Editor of the *Cornell International Law Journal*. **JAMES G. TILLEN** is an associate at Miller & Chevalier, where he specializes in international regulatory compliance counseling and enforcement. Mr. Tillen graduated from The George Washington University Law School where he was a member of *The George Washington Law Review* and a member of the Equal Justice Foundation. He graduated, *magna cum laude*, from the University of Connecticut.

Consider, for example, an FCPA case that came to a dramatic conclusion earlier this year. On June 29, 2005, the District Court of the Southern District of Texas sentenced two former executives of American Rice, Inc. for violations of the FCPA.[2] The defendants were convicted of violations arising from payments to Haitian officials to reduce the Company's customs duties and sales tax assessment. The court agreed with DOJ recommendations and sentenced David Kay, the Vice President of Caribbean Operations, to 37 months in prison, and Douglas Murphy, the President and Chief Executive Officer, to 63 months in prison. These sentences are the longest provided for in any FCPA case to date.

This article examines these cases and their importance for tax personnel and tax advisers navigating international business waters.

I. Overview

Stated simply, the FCPA prohibits the payment of "anything of value" to "foreign officials" (including employees of state-owned or controlled companies and public international organizations), political candidates or political parties, for the purpose of securing improper influence or business advantage.[3] In some cases, companies can be held liable for payments made by third parties acting on their behalf, whether or not the company had actual knowledge of the payment. Issuers of securities on U.S. exchanges are also required to maintain, and to ensure that their affiliates maintain, accurate accounting records and a system of internal controls to ensure accountability for assets.[4]

The DOJ and SEC enforce the FCPA. In addition, section 162(c) of the Internal Revenue Code, which predates the FCPA, prohibits the deduction of bribes, including payments that violate the FCPA, as business expenses.[5]

In the early spring of 2002, Douglas Murphy and David Kay, then president and vice-president, respectively, of American Rice, Inc., a U.S. corporation and "issuer" for SEC and FCPA purposes, were indicted in a criminal prosecution brought by the DOJ in federal district court in Texas.[6] The DOJ charged Murphy and Kay with 12 counts of violating the FCPA, alleging that they had authorized payments to customs officials in Haiti to induce the officials to accept false documents underestimating by one-third the quantity of rice shipped, thereby reducing the customs duties owed on the shipments. This underreporting resulted in discrepancies between volumes on import documentation and actual sales volumes, which allegedly led Murphy and Kay to authorize additional payments to sales tax officials to accept underreporting of sales — again, reducing the company's tax liability.

The defendants launched a vigorous challenge to the charges. They argued, and the district court initially agreed, that payments to tax and customs officials to obtain favorable tax or customs treatment are not made to "obtain, retain, or direct business to any person," as prohibited by the statute.[7] The U.S. Court of Appeals for the Fifth Circuit held, however, in "diametric opposition to the district court," that bribes paid to tax and customs officials can violate the FCPA if the bribery "was intended to produce an effect that would assist in obtaining or retaining business."[8]

At trial on remand, the defendants made the following arguments: (1) the payments were made to avoid costly operational delays in the customs clearance process and, thus, fell within the statutory exception for "facilitation" payments; (2) Haitian officials extorted the payments, negating criminal intent; and (3) the payments were not made to "obtain or retain business," because they were intended to increase profits of an already profitable business.[9]

The jury rejected all these arguments, and found Kay and Murphy guilty on 12 counts of violating the FCPA and 1 count of conspiracy to violate the statute.[10] The jury also convicted Murphy of obstruction of justice stemming from false statements he made to the SEC during its investigation of the payments.[11] The sentences imposed evidence the personal risks to corporate executives who authorize improper payments. Murphy's longer sentence speaks specifically to the consequences of obstructing justice and abusing positions of trust, one focus of the DOJ post-Enron.

Thus, the *Kay* case clarifies that the FCPA applies to nearly all payments made in a business context, a position that the DOJ has long held, but that has not been tested in court. It confirms the relevance of the tax and customs cases that went before it, which, while *Kay* wound its way through the courts, had been called into question. Given the increasing costs of FCPA compliance failures, this attention on tax and customs reinforces the importance of exercising vigilance in supervising expenditures in foreign operations.

II. Tax and Customs Cases

The *Kay* case is the latest in a line of FCPA enforcement matters involving payments to reduce customs and tax assessments. The cases demonstrate the various ways in which corruption can arise in the tax and customs context. They also track the upward trend in enforcement penalties that has characterized FCPA enforcement more generally.

A. Triton Energy

It was a tax-related case in 1997 that ushered in the modern era of increased SEC enforcement of the FCPA. The case involved Triton Energy Corporation, an oil and gas company operating in Indonesia. [12] At the time, the Triton matter was the first case brought by the SEC under the antibribery provisions of the FCPA in more than ten years.

The complaint filed by the SEC alleged violations of both the antibribery and accounting and internal control provisions of the FCPA by Triton and two of Triton Indonesia's officers.[13] It alleged that Triton Indonesia, with the knowledge and participation of the two individuals, made a series of payments totaling approximately US $450,000 to an independent agent for the purpose of influencing certain decisions of Indonesian officials involving an oil field joint venture in Indonesia of which Triton Indonesia was the operator. The payments were disguised as fictitious transactions for the purchase of project goods and services through false invoices from companies affiliated with the agent. The payments were made:

- to government auditors assessing the company's tax liability;
- to an Indonesian government auditing board assessing interest obligations on back taxes;
- to government auditors and the auditing board in connection with their audits of the project's recoverable costs; and
- to tax authorities to secure corporate and value added tax (VAT) refunds.

At the time of the case, these alleged payments fell far outside the prototypical FCPA context of obtaining a government contract.

The parent company was alleged, in effect, to have put its head in the sand concerning its subsidiary's activities. According to the complaint, it failed to remove employees whose ethics had been called into question, failed to take measures to stop the payments after being told of their existence, destroyed a "whistleblowing" memorandum prepared by an internal auditor, and made only partial disclosures to its outside auditors. Significantly, however, the SEC found no evidence that the parent company authorized or directed the subsidiary's actions. This, along with the challenges of pulling together evidence in Indonesia of activities that had occurred nearly 10 years earlier in some instances, likely explains both the civil nature of the suit and the settlement on the basis of only the accounting and internal control provisions.

The company agreed to a permanent injunction and to the payment of a $300,000 civil fine.[14] The settling individual agreed to a permanent injunction against the violation of both the antibribery provisions and the books-and-records provisions, and to the payment of a $50,000 fine.[15]

B. Baker Hughes

In a pair of cases in 2001, payments to reduce tax assessments in Indonesia again created liability for a U.S. company. The cases involved Baker Hughes, a Texas oilfield services company, an Indonesian affiliate of a Big Five (at the time) accounting firm (KPMG), and an Indonesian national who was a partner in the affiliate accounting firm.[16] According to public documents, the cases arose out of a single set of facts. Baker Hughes, an "issuer" under the FCPA, controlled PT Eastman Christiansen (PTEC), an Indonesian corporation headquartered in Jakarta.[17] In February 1999, the Indonesian tax authority notified PTEC that the company owed $3.2 million in taxes to the Indonesian government. Soon after, PTEC retained KPMG Siddharta Siddharta & Harsono (KPMG-SSH) to represent PTEC before the authority.

During KPMG-SSH's meetings with an Indonesian tax official to discuss the merits of the tax assessment, the tax official repeatedly requested that PTEC make a payment to the official. In exchange for the payment, the tax official stated that he would reduce PTEC's tax assessment. The KPMG-SSH employee (an Australian citizen) responsible for the PTEC case (KPMG-SSH Manager) met with Sonny Harsono, a KPMG-SSH partner and Indonesian national, to discuss the tax official's request for payment. Harsono suggested that if Baker Hughes wished to make the payment, KPMG-SSH would make the payment, and would generate a false invoice for KPMG-SSH's services that would cover the cost of the improper payment.

The KPMG-SSH Manager subsequently informed Baker Hughes's Asia-Pacific Tax Manager (BH Tax Manager) of Harsono's suggestion and noted that the Indonesian tax official was willing to reduce the assessment from $3.2 million to $270,000 in exchange for a payment of $75,000. The BH Tax Manager allegedly relayed that information to the Baker Hughes International Controller (BH Controller), and to Baker Hughes's (unnamed in court documents) FCPA adviser. The FCPA adviser informed the BH Controller and the BH Tax Manager that the payment would violate the FCPA and that KPMG-SSH must provide written assurances that it would not make illegal payments. Subsequently, the BH Controller informed Baker Hughes's General Counsel and Baker Hughes's Chief Financial Officer (BH CFO), about the situation. The General Counsel instructed the BH CFO and BH Controller not to enter into the transaction, and to work with the FCPA adviser to resolve the issue.

Contrary to the instruction, settlement documents allege, BH CFO and BH Controller subsequently authorized the BH Tax Manager to proceed with the payment to the Indonesian official. Under the direction of Harsono, KPMG-SSH created and sent a false invoice to PTEC for $143,000, which constitute the $75,000 to be paid to the tax official and the remainder for KPMG-SSH's actual fees. PTEC paid KPMG-SSH the $143,000 and improperly entered the transaction on its books and records as payment for professional services rendered. Soon afterward, PTEC received a tax assessment of approximately $270,000 from the Indonesian tax authority.

Settlement documents state that upon discovering the payment to the Indonesian tax official, Baker Hughes's General Counsel and FCPA adviser undertook corrective action, including the following steps cited by the SEC: attempting to stop payment; reporting to the audit committee, voluntarily disclosing the payment to the SEC and the Justice Department; correcting Baker Hughes's books and records; firing KPMG-SSH; obtaining resignation of senior management officials responsible for the action; challenging the $270,000 tax assessment as erroneous and paying $2.1 million, determined to be the correct tax assessment, to the Indonesian government; and implementing more comprehensive FCPA procedures. Baker Hughes also cooperated with the SEC's investigation, including declining to assert attorney-client privilege with regard to its communications during the period of the Indonesian transaction.

The SEC found that Baker Hughes violated the books-and-records and internal controls provisions of the FCPA. As a result of the settlement, the SEC ordered Baker Hughes to cease and desist from committing or causing any violation of the FCPA, but imposed no fine. The settlement terms highlighted the mitigating effects of Baker Hughes's aggressive internal investigation and remedial action, including termination of senior management officials responsible for the payments and the company's cooperation with U.S. enforcement authorities. Cooperation included the waiver of attorney-client privilege regarding advice during the time period under investigation, a decision that has been encouraged with increasing frequency and emphasis by the Justice Department and the SEC.

Without admitting or denying the allegations against them, KPMG-SSH and Harsono consented to an order that enjoins them from violating and aiding and abetting the violation of the antibribery provisions, the internal controls provisions, and the books-and-records provisions of the FCPA.[18] The decree imposed no financial penalty against the firm or Harsono. This was one of the first FCPA cases against an outside accounting firm. Such cases are common in the general securities fraud area, and their appearance in the FCPA arena reinforced the view, relatively new to lawyers and the Big 5 at the time, that enforcement agencies were willing to target outside professional advisers.

C. Chiquita

Also in 2001, the SEC pursued an enforcement action against Chiquita Brands International Inc. in connection with two improper payments to Colombian customs officials.[19] Chiquita's wholly owned subsidiary in Colombia maintained a number of banana farms and an import/export port facility. In order to renew its license for the port facility, an employee of Chiquita's subsidiary, without the knowledge or consent of any Chiquita employee at the parent and in contravention of Chiquita's policies, directed a customer broker to make an improper payment to Colombian customs officials. The payments were made in two installments from an account used for discretionary expenses. The initial installment was recorded as a maritime donation on the Company's books and the second installment was identified as relating to a maritime agreement. Chiquita's internal audit subsequently discovered the payments. The Company took corrective action, including terminating the employees and reinforcing its internal controls.

Following a range of remedial measures, Chiquita consented to the entry of a cease-and-desist order for a books and records and internal controls violation and paid a fine of $100,000. The case demonstrates the effective strict liability the accounting provisions create for issuers with respect to the acts of their foreign subsidiaries. Unlike Triton, the SEC alleged no facts suggesting that Chiquita was aware of its Colombian activities and specifically noted that the Colombian employee acted in violation of Chiquita's policies.

D. BJ Services

BJ Services (BJS), a publicly traded Delaware company based in Houston, provides oil field equipment to petroleum producers around the world. In 2001, BJS's Argentinean subsidiary (BJSA) made illegal payments of approximately 72,000 pesos (which were valued at 1-to-1 to the US Dollar during this period) to customs officials.[19A] From 1998-2002, other payments were made totaling approximately 151,000 pesos.

In 2001, BJSA was told that a piece of equipment had not been properly imported, and was being held by Argentinean customs. They were also notified by the customs official that the violation would be overlooked if he were paid 75,000 pesos. Otherwise, the equipment would be deported, and BJSA would have forfeited any money already paid to customs and would have been assessed a penalty up to $122,000. Additionally, BJSA would likely have lost the customer for whom the item was being imported. BJSA agreed tp pay the customs official 65,000 pesos, which was delivered through a low level BJSA employee.

The payment was recorded as a debit to a "Vendor Payable Account," and BJSA charged the payment to BJ Services, Panama. BJS Panama paid the 65,000-peso bill and attached the import tax invoice as support for the payment. BJSA then recorded the payment as "Amortization - Fixed Costs."

Later in 2001, BJSA's then-customs manager authorized payments totaling 7,000 pesos to another official so that the 65,000-peso payment would not be revealed. These payments were recorded as duties paid, violating the books-and-records provision of the FCPA.

In 2000, BJSA's former Treasury and Purchasing Manager approved a payment of 10,994 pesos to an official employed by the Secretary of Industry and Commerce. The issue before the official was whether certain equipment could be imported legally into Argentina. BJSA believed it could, and made and recorded the payment as a "facilitation payment" to expedite the process. This payment was deemed improperly recorded in BJSA's books and records.

In 2002, while investigating other financial issues, senior BJS officials became aware that FCPA violations might have occurred at BJSA. They launched a full investigation and subsequently uncovered the above payments and other, smaller payments between 1998 and 2001. BJ Services then "voluntarily and promptly approached the Commission's staff, notified the staff of the results of the investigation, and cooperated with the staff's investigation, including declining to assert its attorney-client privilege with respect to communications during the relevant time period."

BJS was charged with violating the anti-bribery, books-and-records, and internal controls provisions of the FCPA. BJS was subject to a cease-and-desist order, but no fine. The SEC noted that BJS had voluntarily hired an internal auditor, cooperated extensively with the SEC's investigation, and instituted a comprehensive compliance program.

Importantly, all of these cases pre-date Enron and Sarbanes-Oxley. Thus, while their facts are useful to understand the ways in which corrupt payments may arise in the tax and customs context, the penalties imposed are not reliable predictors of how the enforcement agencies would react to such payments in today's environment. Rather, the recent *Kay* case and other recent non-tax related FCPA cases are more valuable guides in that respect.

E. Recent Trends in FCPA Cases

Enacted in 1977, the FCPA generated relatively few cases and almost no case law during its first 15 years. In 2004, by contrast, enforcement agencies brought the largest number of enforcement actions ever, the fines imposed reached record levels, and the government imposed an increasing range of criminal and civil sanctions. Fueled by voluntary disclosures resulting from Sarbanes-Oxley, this trend has continued in 2005, with the resolution of the Titan matter in March 2005 resulting in the largest penalty for an FCPA case to date. The Titan plea agreement included one count of a criminal tax violation. Titan's criminal tax violation stemmed from the fact that the Company wrote-off as bad debt certain expenses that included improper payments to officials.[20] The DOJ charged Titan with a violation of 26 U.S.C. § 162(c), which prohibits taxpayers from deducting any direct or indirect payment made to an official or employee of any government, or of any agency or instrumentality of any government, if the payment constitutes an illegal bribe or kickback or is unlawful under the FCPA.

Recent FCPA Resolutions

Case	Year	DOJ	SEC	Total
Titan Corporation	2005	$13 million	$15.479 million disgorgement $13 million (credit for DOJ fine)	$28.479 million
ABB	2004	$10.5 million	$5.9 million disgorgement $10.5 million (credit for DOJ fine)	$16.4 million
DPC	2005	$2 million	$2.8 million disgorgement	$4.8 million
GE-In Vision	2005	$800,000	$617,703 disgorgement $500,000 fine	$1.918 million
Monsanto	2005	$1 million	$500,000	$1.5 million
Schering-Plough	2004		$500,000	$500,000
Micrus	2005	$450,000		$450,000

As the nearby chart reflects, in addition to fines, the SEC has also directed companies to disgorge their profits from transactions involving bribery, which can significantly increase penalties. Moreover, in six of the last seven enforcement actions, the settlement terms included a requirement that the company involved retain an independent compliance expert or monitor for a period of 90 days to three years. Enforcement officials have stated that such compliance monitors are likely to be routine elements of future dispositions. The monitor function enticingly provides the government with ongoing enforcement leverage. At no cost to the government (the companies pay the fees of the monitors), enforcement agencies are able to continue a review of a company's compliance program and practice, free of the constraints (and protections) of attorney-client privilege vis-à-vis the agencies.

Another trend in recent cases is the developing practice of FCPA compliance due diligence in the merger & acquisition context. A half dozen cases, including Titan, ABB, and GE-InVision, came to the attention of enforcement officials in this context. In these cases, the purchasing company and the target company discovered the potential bribes either in anticipation of a sale (in the case of ABB), or, in the others, during M&A due diligence and voluntarily reported them to the government in an effort to resolve the matter before completion of the M&A transaction. The proposed Titan/Lockheed fell apart before Titan was able to resolve its enforcement matter with the government. The ABB and InVision transactions, however, ultimately went forward. In all of these cases, the companies involved spent tens of millions of dollars in legal and accountant fees, in addition to the fines and penalties imposed. In those transactions that survived, the buyer was forced to accept a lower sale price, with discounts reportedly ranging from 9 to 27 percent.

III. Practical Steps to Prevent Improper Tax and Customs Payments

Tax personnel and tax advisers can take a variety of steps to protect their companies and navigate the minefield of FCPA risk in the customs and tax arena. Close supervision of the business practices of foreign subsidiaries, careful selection and monitoring of third parties, and examination of FCPA compliance issues in M&A transactions will significantly mitigate FCPA risks. Companies must train employees to spot FCPA issues as they are likely to arise in the employees' day-to-day activities and responsibilities.[21] In addition, the training should cover retention of third parties, compliance with FCPA policies and procedures, and accurate recordkeeping.

A. Supervision of Affiliates and Subsidiaries

As the *Chiquita* case demonstrates, the actions of foreign subsidiaries can create FCPA liability for parent companies even if the parent company has no knowledge of the underlying activity. The books-and-records provisions of the FCPA, which apply to issuers, in effect hold parent companies strictly liable for the actions of their subsidiaries.[22] As a result, it is extremely important that companies develop and enforce FCPA compliance policies and internal controls for foreign subsidiaries. Such policies should explain the FCPA (and any relevant local law) and set forth procedures governing common FCPA risk areas, such as gifts and entertainment, facilitating payments, and retention of third parties.

Internal controls should ensure that outlays of funds are carefully controlled. Such controls include delegations of authority that account for legal risk, requiring multiple signatories for expenditures, limiting ability to establish bank accounts, and restricting uses of petty cash. It is also important to understand the local tax and customs regimes where subsidiaries are located. By anticipating tax liabilities, companies can more easily spot and investigate unusual assessments and expenditures. Finally, detailed auditing of expenses and expenditures associated with taxes and customs can deter and detect improper payments.

B. Review of Third Parties

The *Triton*, *Baker Hughes*, and *Chiquita* cases all involved payments made to officials through a third party. Carefully selecting and monitoring third parties can significantly reduce the risk of improper payments. In the tax context, the due diligence process would extend to all third parties involved in tax controversy and discretionary tax issues, including lawyers, accountants, and other tax advisers; similarly, any third parties engaged to assist in customs clearance and compliance, including customs brokers, freight forwarders, lawyers, and accountants, should be properly vetted.

In selecting third parties, companies should confirm that the third party will adhere to FCPA anti-corruption principles. American companies active abroad typically have developed systems for due diligence, but not all have consistently applied them to third parties retained for a tax and customs-related function, particularly if those third parties are professional services firms.

In general, the purposes of FCPA due diligence with respect to third parties with which a business relationship is proposed are: (1) to assess the reputation of the third party, especially with regard to ethical issues; and (2) to determine whether any foreign official may be involved in the third party as an owner, officer, director, or employee, so that the risks of that involvement can be evaluated and appropriate safeguards developed.

To obtain information necessary to assess a third party's reputation and its potential relationship with foreign officials, a comprehensive background check should be conducted. Information can be gathered from internal company sources, public records, news articles, internet searches, Dun & Bradstreet reports, U.S. embassies, references, and the third party itself. The information should be reviewed to determine whether there are any warning signals suggesting the third party is likely to make improper payments. Such "red flags" include: requests by the third party to be paid in an offshore account; inability to determine actual owners of the company; personal, business, or family relationship with a foreign official; requests for compensation exceeding the "going rate"; and objection by the third party to FCPA representations in the agreement. FCPA due diligence by its nature is an iterative process, and must be tailored to the facts and circumstances presented by each engagement. It is not a check-the-box exercise.

Written contracts with FCPA terms can further protect companies from liability for the actions of third parties. Obviously, a contract should include a clause prohibiting the third party from making improper payments to officials. In addition, requiring the third party to obtain advance approval from the company before meeting or entertaining officials can reduce risk. A contract should also allow for unilateral termination in the event the third party breaches these clauses. A contract should also require that the third party provide detailed invoices describing services and require back-up documentation for any expenses incurred relating to the services. Additional protection can be obtained by requiring the third party to maintain accurate books and records and providing the company with a right to audit those books and records.

In conjunction with execution of the contract, companies should educate the third party about the requirements of the FCPA and relevant local laws concerning bribery. This can be done through providing the third party with the company's FCPA policies as well as through on-line or face-to-face training, depending on what is reasonable and appropriate given the circumstances of the relationship.

Following retention, it is important to monitor the relationship. Invoices should be examined to determine if they match the compensation terms of the contract, whether expenses are accompanied by sufficient documentation, and whether there are any unusual amounts or activities evident. Employees working with the third party should also be sensitized to report any red flags exhibited by the third party.

C. FCPA Due Diligence of Tax Practices in Mergers & Acquisitions

As previously discussed, one recent trend is disclosure of FCPA issues discovered during due diligence conducted in conjunction with M&A transactions. Purchasing companies are likely motivated to encourage disclosure and resolution before completion of the transaction in order to avoid successor liability, and to avoid implications for Sarbanes-Oxley quarterly certifications on internal controls. As with many FCPA issues, the legal issue of what acts, omissions, or circumstances may give rise to successor liability on the part of an acquirer has not been squarely addressed, since the cases have all been settled rather than fully litigated. What is clear, however, is that enforcement officials expect acquiring companies to undertake FCPA due diligence with respect to the target, and put a halt to any ongoing activity or transaction that raises FCPA issues.

In the FCPA context, the extent of due diligence may vary with whether the target does business in corrupt countries, whether the target's business involves interaction with foreign governments, and whether the target employs third parties. Such due diligence inquiries could include the following:

- In what countries does the target engage in business operations of any form? Does the target engage in business in a country with corruption problems (see www.transparency.org for national corruption information)?
- Does the target company use intermediaries (*e.g.*, joint ventures, consultants, representatives, finders, agents) to conduct activities in foreign markets?
  - Is there documentation that appropriate due diligence was performed before hiring or engaging the intermediary?
  - Are FCPA contractual safeguards included in contracts with intermediaries or other third parties?
  - Is there monitoring of existing third party relationships for red flags?
  - Are payments to third parties recorded in the target company's books and records?
- Are there procedures in place that establish:
  - Authorities for approving facilitating payments?
  - Authorities for approving entertainment and gifts for foreign officials?
- Do the books and records accurately reflect the transactions of the company?
- Do internal controls exist to ensure transactions are properly executed?

If red flags emerge, additional reviews should be performed. When examining the books and records, transactions related to tax and customs should receive scrutiny, and those conducting tax due diligence should talk through any pending controversies and other discretionary issues outstanding, understand how the target has approached and resolved such issues in the past, including whether they have retained third parties to assist them. If so, those third parties should also be part of the due diligence to evaluate potential risk from their activities on behalf of the target.

All of these steps, in the context of an effective overall compliance program and internal controls, can help to reduce an organization's risk of FCPA liability. As recent enforcement trends make clear, that risk has become more significant and, in the M&A context, potentially fatal. The tax function plays an important role in FCPA compliance. To be effective in that role, tax personnel must be aware of the risk of corruption in dealings abroad, be trained to spot it when it arises, and coordinate with the legal and audit functions to address it.

◆◆◆

[1] *See* 15 U.S.C. §§ 78dd-1(a), 78dd-2(a), and 78dd-3(a).

[2] *See United States v. Kay*, Criminal Action No. H-01-914 (S.D. Tex. June 29, 2005)(Sentencing Notices); *United States v. Murphy*, Criminal Action No. H-01-914 (S.D. Tex. June 29, 2005) (Sentencing

Notices).

[3] *See* 15 U.S.C. §§ 78dd-1(a), 78dd-2(a), and 78dd-3(a).

[4] *See* 15 U.S.C. § 78m(b).

[5] I.R.C. § 162(c).

[6] *See United States v. Kay*, Criminal Action No. H-01-914S (S.D. Tex. March 25, 2002) (Superseding Indictment).

[7] *United States v. Kay*, 200 F. Supp. 2d 681, 686 (S.D. Tex. 2002).

[8] *United States v. Kay*, 359 F.3d 738, 756 (5th Cir. 2004).

[9] *See United States v. Kay*, Criminal Action No. H-01-914 (S.D. Tex. June 28, 2005) (Sentencing Memorandum of the United States).

[10] *See United States v. Kay*, Criminal Action No. H-01-914 (S.D. Tex. June 29, 2005) (Sentencing Notices); *United States v. Murphy*, Criminal Action No. H-01-914 (S.D. Tex. June 29, 2005) (Sentencing Notices).

[11] *See United States v. Murphy*, Criminal Action No. H-01-914 (S.D. Tex. June 29, 2005) (Sentencing Notices).

[12] *See Securities & Exchange Commission v. Triton Energy Corp.*, Civil Action No. 97CV00401 (Dist. Ct. D.C. 1997) (Final Judgment of Permanent Injunction).

[13] *See Securities & Exchange Commission v. Triton Energy Corp.*, Civil Action No. 97CV00401 (Dist. Ct. D.C. February 27, 1997) (Complaint).

[14] *See Securities & Exchange Commission v. Triton Energy Corp.*, Civil Action No. 97CV00401 (Dist. Ct. D.C. 1997) (Final Judgment of Permanent Injunction).

[15] *See Securities & Exchange Commission v. Philip W. Keever*, Civil Action No. 97CV00401 (Dist. Ct. D.C. 1997) (Consent & Undertaking).

[16] *See In the Matter of Baker Hughes Incorporated*, Civil Action No. H-01-3106 (S.D. Tex. 2001)(Settlement Order); *United States, et. al. v. KPMG Siddharta Siddharta & Harsono et al.*, Civil Action No. H-01-3105 (S.D. Tex 2001)(Settlement Order).

[17] *See In the Matter of Baker Hughes Incorporated*, Civil Action No. H-01-3106 (S.D. Tex. 2001)(Settlement Order).

[18] *See United States, et. al. v. KPMG Siddharta Siddharta & Harsono et al.*, Civil Action No. H-01-3105 (S.D. Tex 2001) (Settlement Order).

[19] *See In the Matter of Chiquita Brands International, Inc.*, Civil Action No. 01CV02079 (Dist. Ct. D.C. Oct. 3, 2001)(Settlement Order).

[19A] *See In the Matter of BJ Services Company,* Administrative Proceeding File No. 3-11427 (March 10, 2004) (Order Instituting Cease and Disist Proceedings, Making Findings, and Imposing a Cease and Disist Order).

[20] *See United States v. Titan*, Case No. 05CR0314-BEN (S.D. Cal. March 2005).

[21] For example, training for employees involved with customs and tax issues should cover "facilitating payments." Facilitating payments are small payments to low-level officials to secure routine government action. Customs and tax officials often request such payments (for example, officials often demand small payments to expedite inspections or processing of goods). Facilitating payments are allowed as a narrow exception to the FCPA. *See* 15 U.S.C. §§ 78dd-1(b), 78dd-2(b), and 78dd-3(b). However, local laws often prohibit them. Employees need to be able to distinguish between acceptable facilitating payments and unacceptable bribes, and the issues raised by local law prohibitions. If facilitating payments are made, employees also need to correctly record the payments in the company's books and records. Companies can be liable under the FCPA's books-and-records provisions for improperly recording facilitating payments even if they are acceptable under the anti-bribery provisions.

[22] *See* 15 U.S.C. § 78m(b).